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Supreme Court of the United States.

Filed July 1, 1902.

GEORGE H. EARLE, JUNIOR,
Receiver of The Chestnut Street National Bank, Plaintiff in Error,

vs.

SUSAN CARSON.

In Error to the United States Circuit Court of Appeals for the Third Circuit.

Transcript filed April 16, 1901.
(18,119.)

BRIEF OF PLAINTIFF IN ERROR.

ASA W. WATERS,
CHARLES BIDDLE,
Attorneys for Plaintiff in Error.

T. C. DAVIS & SONS, PRINTERS, PHILA.

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STATEMENT OF THE CASE.

(The page references in brief are to transcript of record.)

The Chestnut Street National Bank was duly incorporated and organized under the National Banking Act, and did a banking business for many years in the City of Philadelphia, Pennsylvania. The capital stock of said banking associ-

ation is $500,000, divided into 5000 shares of $100 each (pp. 5, 6). The Comptroller of the Currency of the United States closed the bank's doors to business on December 23, 1897, and on January 29, 1898, George H. Earle, Jr., was appointed by the Comptroller its Receiver and was duly qualified as such. On April 1, 1898, the Comptroller made an order, under Sections 5151 and 5234 Revised Statutes of the United States, for an assessment of 100 per cent. upon the bank's capital stock for the benefit of its creditors, and the Receiver was directed in writing to collect the same by suit or otherwise from each shareholder (p. 12).

Susan Carson (defendant in error) became the owner of ten shares of the stock of the bank on September 29, 1896, and was duly entered upon the stock ledger, and registered by the Chestnut Street Trust and Saving Fund Company, as appears on certificate No. 464, issued by the bank in her name, dated September 28, 1896 (p. 63). Her name appears in the official list of shareholders required to be kept by the provisions of Section 5210, of the Revised Statutes, and the shares have so continued to be registered in her name without change, and were so registered on April 1, 1898, when the

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assessment was made by the Comptroller. It is conceded that the defendant is *prima facie* a shareholder liable to creditors for the assessment.

The present action was brought by the Receiver to recover the assessment made by the Comptroller of the Currency upon the stock of Susan Carson so registered in her name.

The Receiver proved at the trial that the defendant appeared as the registered owner of ten shares of stock; that the bank closed its doors upon December 23, 1897; and that the Comptroller of the Currency had made an assessment on the stock of 100 per cent.

The defendant denied the right of the Receiver to recover, and as her defence produced testimony to show that, on December 2, 1897, three weeks before the bank's doors closed, she offered her shares for sale at public auction, and they were knocked down to one William Steele, the only bidder who bid par for them, that when payment was made, she delivered to him the certificate with an assignment and power of attorney attached executed in blank, and requested that the transfer be entered on the bank's books, that this was all she could do to complete the transfer. William Steele was cashier of the bank at the time. He bought

the stock for the account of William M. Singerly, president of the bank, but this was not known to the defendant until after the bank's public failure.

It was shown at the trial that the money of the bank was fraudulently abstracted to pay for the stock which was thus purchased from the defendant, and that Mr. Steele, upon behalf of Mr. Singerly, took the defendant's certificate, put it in the cash drawer of the bank, and called it a cash item.

The specific cause for defendant's offering her shares for sale, it was testified, was the fact that the "reserve fund" of the bank was below the amount required by law, and was diminishing (pp. 38–40).

The plaintiff, in rebuttal, offered to prove that the alleged assignment of the stock by the defendant *was void*, and as to creditors she remained a stockholder of the bank when the assessment was made. The reasons given why the assignment was void were as follows:

First.—The plaintiff offered to show that the bank was insolvent when the defendant offered her stock for sale on December 2, 1897, and was in the same condition that it was upon December 23, 1897, when its doors were closed.

Second.—The plaintiff further offered to show that Mr. Singerly, to whom the stock was sold by the defendant, was insolvent at the time of the sale, and was now unable to respond to the assessment.

Third.—That the specific cause of offering the shares for sale was that the reserve fund of the bank was below the amount required by law, and this was notice and should have put her upon inquiry as to the failing condition of the bank.

Fourth.—That the defendant did not show that she had complied with the by-laws or articles of association of the bank when she attempted to establish that she had transferred her shares of stock, nor that the bank was without articles and by-laws.

Fifth.—That the payment by Steele of the bank's funds put her upon inquiry as to the fraudulent abstraction of the funds of the bank.

The Court declined to permit the plaintiff to establish his first and second offer, and sustained the objection of the defendant that such proof was inadmissible unless it was shown that the defendant had knowledge of the insolvency of the bank at the time she made the assignment. The Court further overruled the other reasons advanced by the plaintiff to

show that the assignment was void, and declined to give binding instructions to the jury. Exceptions were taken to these rulings, and upon writ of error to the Circuit Court of Appeals, that Court sustained the Trial Court, and the present writ of error was taken.

The three suits of George H. Earle, Jr., Receiver of the Chestnut Street National Bank, against Susan Carson, Annie C. Carson, and Hampton L. Carson, were tried as one case, each of these defendants having ten shares of stock in the Chestnut Street National Bank, and upon each ten shares one thousand dollars with interest from April 1, 1898, was due. It was agreed by counsel that the facts in all three cases were similar.

A verdict was rendered in favor of the defendants.

ASSIGNMENT OF ERRORS.

(See pages 73 to 76 of Record.)

First.—The plaintiff in error assigns as error the several errors set out in the Assignment of Errors forming part of the record in the above entitled action before said Circuit Court of Appeals, to wit:

1. The Court erred in refusing to allow the plaintiff to show that at the time of the sale of this stock by the defendant, on December 2, 1897, the bank was insolvent, and in the same condition that it was upon December 23, 1897, when its doors were closed. (See p. 44 of printed Record.)

2. The Court erred in refusing to allow the plaintiff to show that Mr. Singerly, to whom the defendant sold her stock, was insolvent. (See p. 44 of printed Record.)

3. The Court erred in refusing to charge that under all the evidence in the case the verdict should be for the plaintiff.

4. The Court erred in not affirming the second point submitted by the plaintiff, which is as follows: "It is not sufficient if the buyer of the stock promised to make the transfer, if he fraudulently or negligently failed to have done it. The seller of the stock is liable to creditors."

5. The Court erred in not affirming plaintiff's third point, to wit: "If you believe the delivery of the stock was made to Mr. Steele as the agent for the purchaser and not as the cashier of the bank, the defendant did not do all that she could have done to have the stock transferred, and is, therefore, liable."

6. The learned Court erred in refusing plaintiff's fifth point, which was as follows: "If the bank was insolvent when the stock was sold, and the person to whom it was sold is for any reason unable to pay the assessment, the defendant is liable, and your verdict must be for the plaintiff." (See p. 50 of printed Record.)

7. The Court erred in declining plaintiff's sixth point, which was as follows: "If you believe that the result of the sale of the stock of the defendant was to secure the purchase money from the cash drawer of the bank, whether she knew it or not, she cannot even come into a court of equity with clean hands, and is not entitled to equitable relief."

8. The Court erred in denying plaintiff's seventh point, which was as follows: "If the bank was insolvent when the defendant's stock was sold, the plaintiff is entitled to recovery. The insolvency of

the bank prevents a stockholder from selling his stock to escape liability." (See p. 50 of printed Record.)

9. The Court erred in denying plaintiff's eighth point, which was as follows: "If the bank was insolvent when the stock in this case was sold, then the liability of the defendant was fixed, and even if the stock was transferred it was a voidable sale as against creditors, and the plaintiff is entitled to recovery." (See p. 50 of printed Record.)

10. The learned Court erred in not ruling as a matter of law that a shareholder of a national banking association, under Sections 5151 and 5234 of the Revised Statutes of the United States, is individually contractually responsible to pay the bank's contracts, debts and engagements, although he in good faith sold his shares at public auction three weeks before the bank suspended payment of its obgliations and closed its doors to business, if the bank at the time of such sale is in fact insolvent and the vendee and intended transferee is financially irresponsible to pay the bank's contracts, debts and engagements as provided in the Revised Statues aforesaid, and such selling shareholder is not released from his individual contractual liability

by a delivery of his certificate and power to transfer same to the cashier of the bank with a request that the shares be transferred at once upon the books of the bank, although acting in good faith, if, at the time of such request for transfer, the bank is in fact insolvent and the intended transferee is financially irresponsible.

11. The learned Court erred in not ruling as a matter of law that the burden of proof is upon the defendant to show that everything was done by her "in such manner as may be prescribed in the by-laws or articles of association" pursuant to the provisions of Section 5139 of the Revised Statutes of the United States that careful, prudent business men could reasonably do in order to effect a transfer of their shares upon the books of the bank, and to this end the burden was upon her to either offer in evidence at the trial the by-laws or articles of association of the bank, or show that the bank had neither by-laws nor articles of association upon the subject.

12. The learned Court erred in not ruling that it is a legal presumption that defendant, at the time of offering her shares for sale, had notice and knowledge of the provisions of Section 5191 of the

Revised Statutes of the United States and all other provisions of the National Bank Act then in force.

Second.—The said Circuit Court of Appeals for the third circuit, before which was heard the writ of error which brought up the record in this action from the Circuit Court of the United States for the Eastern District of Pennsylvania to said Circuit Court of Appeals, erred in making its order on the 14th day of March, 1901, affirming the judgment of said Circuit Court and directing the mandate to issue to the said Circuit Court directing that Court to proceed in accordance with the decision and order of said Circuit Court of Appeals.

Third.—That the learned Circuit Court of Appeals for the third circuit erred in not making an order upon the law and evidence in the case reversing the judgment of said Circuit Court, and directing the said Circuit Court to enter judgment as of March 14, 1901, for the plaintiff in error, and against the said defendant in error, Susan Carson, in the sum of $1,175.33, besides costs, because,

(*a*) That said Susan Carson had some notice through her brother before offering her stock for sale that the bank was in a failing condition, to

wit, that its reserve fund was less than that required by law, and it put her upon inquiry as to the true financial condition of the bank, and even if selling in good faith as between herself—a shareholder—and creditors, both being innocent parties, she as a shareholder is liable, and her sale of the shares to escape the liability of a shareholder.

(*b*) That if the sale was made to William Steele, individually, or to him as agent of William M. Singerly, the president of the bank, the delivery of the certificate of stock for transfer to him was not a delivery to the bank. (See Record, pp. 4, 42, 43, testimony of Edward L. Maguire.)

(*c*) That if the sale was made to William Steele as cashier of the bank, for the bank, the defendant in error had notice of its invalidity under Section 5201, United States Revised Statutes, and the payment to her of a clearing-house due bill by the cashier showing on its face that the funds paid were those of the bank put her upon inquiry as to the real purchaser. (See Record, pp. 23, 25, 27, testimony of William Steele.)

(*d*) That no actual transfer was ever made upon the books of the bank of the shares from the name of the defendant in error, and the record does not

show that the request, if made, was for a transfer in the manner prescribed by the by-laws or articles of association of the bank, as required by Section 5139, United States Revised Statutes. No offer of the by-laws nor proof that the bank is without by-laws is in evidence.

Fourth.—That the learned Circuit Court of Appeals for the third circuit erred in not reversing the ruling of said Circuit Court upon exception noted for the plaintiff at the trial, wherein it refused to permit the plaintiff in error to show to the jury that the bank at the time of the sale of the shares by the defendant in error was in fact insolvent and in the same condition that it was on December 23, 1897, when its doors were closed, and that the liability to its creditors, as holders thereof, had become so fixed and attached to her individually, that she could not relieve herself therefrom by a sale, although made in good faith, if to one financially irresponsible, and that the intended transferee of the shares was in fact insolvent and unable to respond to the creditors of the bank for its contracts, debts and liabilities, and this he offered to prove. (See p. 44, testimony of George H. Earle, Jr.)

Fifth.—That the Circuit Court of Appeals for the third circuit erred in not sustaining the writ of error then before it, and in not reversing the judgment entered in this action in said Circuit Court.

ARGUMENT.

The plaintiff in error contends first that the assignment made by the defendant was void, for the following reason:

A stockholder in a national bank cannot escape liability for an assessment on her stock by selling that stock to an insolvent person after the bank has become insolvent, and ignorance on her part of the bank's insolvency is immaterial. This question is presented by the First, Second, Sixth, Eighth and Ninth Assignments of Error, which are set out on pages 7, 8 and 9 of this brief.

If this contention is sound it is unimportant what steps the defendant in error took to have her stock transferred upon the books of the bank; if such transfer had been actually made, she would still remain a stockholder liable to the assessment, if the assignment was void by reason of her statutory liability.

The trial Court held that the present Receiver must show, in order to set aside the assignment set up as a defence, not only that the bank was insolvent at the time the defendant sold her stock, but that *she knew it or had notice of it* when she made

the sale to the insolvent purchaser and sold her stock with an *intent* to escape a threatened liability.

In determining whether this ruling is correct, it is first necessary to examine into the character of the undertaking between a stockholder of a national bank and a creditor.

Section 5151 of the Revised United States Statutes imposes the obligation upon the stockholder in the following words:

> "The shareholders of every national banking association shall be held individually responsible, equally and ratably and not one for another, for all contracts, debts and engagements of such association, to the extent of the amount of their stock therein, at the par value thereof in addition to the amount invested in such shares."

The liability imposed by this Act constitutes a contract between the creditors of the bank and the persons who are its stockholders when the debt is contracted.

Morse on Banking gives the case of **Iron vs. Manufacturers' National Bank,** 21st Federal Rep., p. 197 (1884), for his authority as to the liability imposed by this Act. In that case the Judge says:

> "So far as the clause of the National Bank Act which I have quoted (which was Sec. 5151) has been construed by the Court, it seems to me to have been assumed that it was the intention of Congress to

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make this a contract liability. . . . From all the various provisions of the Act, it seems to me that it was the intention of Congress to make this liability . . . an asset of the bank, to be resorted to in the event of insolvency. . . ."

Morawetz on Private Corporations, Vol. 2, Sec. 870, states the relationship between shareholder and creditors as follows:

"If the company's charter provides that the shareholders shall be subject to a special individual liability to creditors, persons becoming shareholders agree to become liable, both in a corporate capacity and individually, to all persons who shall give credit to the corporation. They offer to all the world to become liable in their corporate capacity, to the extent of the capital which they have agreed to contribute for the purpose of carrying on the company's business, and they offer to become liable individually to the amount expressly provided by their charter or incorporation law. Parties who contract with the corporation contract upon the faith of this liability, held out as their security; and the offer of the shareholders, being thereby accepted, ripens into a binding contract."

In **Hobart vs. Johnson,** 8th Federal Rep., p. 495 (1881), Blatchford, J., says:

"Every creditor of the bank, becoming such, becomes, *eo instante,* a creditor of the shareholder in respect to the liability in question. The shareholder becomes thereby a principal debtor. The debt of the bank is his debt at the instant of its creation, and the debt of the bank is referred to only as a measure of the debt of the shareholder. . . . The idea of

guaranty or suretyship, or of a promise to pay the debt or answer for the liability of another, is altogether destroyed by the fact that the debt of the bank is incurred for the benefit of the shareholders exclusively, and is thus the debt of the shareholder as a principal."

In **Whitman vs. Oxford National Bank** (1900), 176 U. S., 559, this Court says, through Mr. Justice Brewer, on page 565:

"In *Richmond vs. Irons*, 121 U. S., 27, in which the question presented was whether the individual liability of a stockholder in a national bank survived as against his administrator, it was said (p. 55):

"'Under that Act the individual liability of the stockholders is an essential element in the contract by which the stockholders became members of the corporation. It is voluntarily entered into by subscribing for and accepting shares of stock. Its obligation becomes a part of every contract, debt and engagement of the bank itself, as much so as if they were made directly by the stockholder instead of by the corporation. There is nothing in the statute to indicate that the obligation arising under these undertakings and promises should not have the same force and effect, and be as binding in all respects as any other contracts of the individual stockholder.'"

"In *Concord National Bank vs. Hawkins*, 174 U. S., 364, 372 (1899), in which one national bank was sought to be charged as a stockholder in another national bank, was this declaration:

"In the present case it is sought to escape the force of these decisions by the contention that the liability of the stockholder in a national bank to respond to an assessment in case of insolvency is not contractual, but statutory.

> "Undoubtedly, the obligation is declared by the statute to attach to the ownership of the stock, and in that sense may be said to be statutory. But as the ownership of the stock in most cases arises from the voluntary act of the stockholder, he must be regarded as having agreed or contracted to be subject to the obligation."

It is so well settled by this Court that the obligation of the shareholder to creditors, within the meaning of Section 5151 Revised Statutes, is in every particular a contract entered into voluntarily by the shareholder when he becomes such, it is unnecessary to quote further authorities.

The liability of the stockholder attaches when the bank becomes insolvent.

The obligation on the part of the stockholder has been directly decided in **Stuart vs. Hayden,** 169 U. S., p. 8 (1898), to be a contractual one, and one that attaches when the bank becomes insolvent. This Court states:

> "The safety of national banking associations, so far as its creditors are concerned, depends largely upon the security given by the statutory provision entitling creditors to look to the individual liability of shareholders. . . . . .
>
> "The right of creditors of a national bank to look to the individual liability of shareholders, to the extent indicated by the statute, for its contracts,

debts and engagements, *attaches when the bank becomes insolvent*, and the shareholder cannot, by transferring his stock, require creditors to surrender this security as to him, and compel the receiver and creditors to look to the person to whom his stock has been transferred. This Court has said that 'the individual liability of the stockholders is an essential element in the contract by which the stockholders became members of the corporation. It is voluntarily entered into by subscribing for and accepting shares of stock. Its obligation becomes a part of every contract, debt and engagement of the bank itself, as much so as if they were made directly by the stockholder instead of by the corporation.'"

The liability of the stockholder is therefore a contractual one, the obligation "*attaches when the bank becomes insolvent*," and when that event happens the stockholder should not be permitted to escape his liability.

The Act should be construed strictly.

The Act of Congress limiting the liability of the stockholder to double the amount of his stock is in derogation of the common law liability of partners, and should be strictly construed, and the double liability imposed should be as carefully guarded as is the obligation to pay the original subscription to the stock.

The statutes of the United States encourage creditors to trust to their right of recovery against the

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stockholders. Section 5210 provides that a list of the stockholders shall be kept for the inspection of the creditors so that they may find out to whom they may have the privilege of looking for the payment of their debts upon the insolvency of the bank; and as was said in **Langtry vs. Wallace,** 97 Fed. Rep., p. 867 (1899):

> "All persons are, in law, presumed to extend credit to corporations, and especially to national banks, whose shares are subject to a double assessment, in reliance upon the amount of their issued capital stock, although they do not know accurately by whom such stock is at the time held."

In **Upton vs. Englehart,** 3 Dill., p. 496, Fed. Cas. No. 16,800 (1875), the Court says:

> "If a person has accepted a certificate of stock, and becomes, to all external appearance, a stockholder, persons may have become creditors of the company on the faith of his membership, and in law are presumed to do so."

A creditor knows the stockholders may change from time to time, but he should be allowed to feel certain that the *right of transfer ceases upon the insolvency of the bank*, and that when Section 5210 provides that the list of all the stockholders with their addresses and the number of shares held by each shall be kept at the bank subject to creditors' inspection, it is not intended that there shall be

held out to him a security that may not only change in times of prosperity but may disappear in the time of adversity; this would be setting a trap for the careful man and using the Act of Congress but as a bait to catch him.

This Court has said that the obligation of the stockholder to pay "*attaches when the bank becomes insolvent.*" It is inconsistent with this ruling for the lower Court to hold that both insolvency and knowledge must be shown before the obligation becomes binding; it is placing an additional requisite not authorized by the higher Court. The stockholder contracts to be responsible upon the happening of a certain event; he cannot remain in ignorance of that event and present that ignorance as a defence to the binding effect of his agreement.

In no other instance is a suitor upon a contract required to show the frame of mind of his obligor when the time for performance arrives.

It is hard to conceive that a creditor, before he can recover from a stockholder, must say to him: You contracted to repay me to the extent of your stock if the bank became insolvent or unable to fulfill its contract with me; I find you assigned your stock after that event happened, to one who cannot pay

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the assessment. When you made the sale did you know that your obligation to pay me had matured? If you did not know it, I cannot recover.

It is a matter of indifference how pure the action of the stockholder may be or how small his knowledge; he becomes liable by reason of the happening of the contingency against which he had contracted, and he should not be allowed to escape from the obligation, by an assignment to an insolvent person.

If want of knowledge is to be a protection to a stockholder it would place a premium upon ignorance, and stimulate stockholders to take as little interest as possible in a corporation which they hold out to the world they are conducting and whose profits they are sharing.

What right has a stockholder to plead ignorance? He should have known the condition of the bank of which he is a part, and if he does not know it, it is because his own agents, the officers of the bank, have concealed it from him; and if they have done so the stockholder should not be allowed to profit by their fraud and escape liability. If the stockholder is ignorant it is an ignorance of facts that he should have known and is no excuse. *Ignorantia eorum quae quis scire tenetur non excusat*, Broom Max, 253. The statutes permit him to enter into

the business of banking with a limited liability; the privileges of such a partnership should not be extended to permitting the employment of agents whose knowledge can in no way affect their principals.

Decisions of the Courts upon the subject.

This Court has never had occasion to consider whether insolvency alone is of itself sufficient to hold a stockholder and prevent his escaping the liability that had attached to him; in every case there has been some fact that has been construed as giving the stockholder notice of the insolvency of the bank, but although this point has not been directly passed upon, this Court has clearly stated the law; and has said that where an assignment has been made to an *insolvent person after the bank has become insolvent, the stockholder by such assignment does not escape his liability.*

This Court in **Stuart vs. Hayden,** 169 U. S., p. 9, when defining the liability under section 5151, states:

> "Whether—the bank being in fact insolvent—the transferrer is liable to be treated as a shareholder in respect of its existing contracts, debts and engagements if he believed in good faith, at the time of transfer, that the bank was solvent, is a question which, in the view we take of the present case, need not be discussed; *although he may be so treated, even*

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when acting in good faith, if the transfer is to one who is financially irresponsible."

This statement of the law clearly establishes the contention of the appellant in this case. It is argued that this ruling is a dictum; this may be true, but an examination of the authorities clearly shows that it is in accord with the decisions and with the text writers upon the subject, and was not stated by Mr. Justice Harlan without consideration.

That insolvency instantly changes the relationship between stockholders and creditors was held in **McDonald, Receiver, vs. Williams,** 174 U. S., p. 397 (1899). In this case an action was brought by the receiver of a national bank to recover back a dividend which had been paid to a stockholder out of the capital of the bank, the bank at the time being insolvent. The question then arose as to whether the solvency or insolvency of the bank affected the status of the parties.

Mr. Justice Peckham, in delivering the decision of the Court, states as follows (p. 401):

> "In *Graham vs. Railroad Company,* 102 U. S., 148, 161, it was said by Mr. Justice Bradley in the course of his opinion, that 'When a corporation becomes insolvent, it is so far civilly dead that its property may be administered as a trust fund for the benefit

of its stockholders and creditors. And a court of equity, at the instance of the proper parties, will then make those funds trust funds, which, in other circumstances, are as much the absolute property of the corporation as any man's property is his.'

"And in *Hollins vs. Brierfield Coal & Iron Company*, 150 U. S., 371, 383, 385, it was stated by Mr. Justice Brewer, in delivering the opinion of the court, and speaking of the theory of the capital of a corporation being a trust fund, as follows:

"'In other words, and that is the idea which underlies all these expressions in reference to 'trust' in connection with the property of a corporation, the corporation is an entity, distinct from its stockholders as from its creditors. Solvent, it holds its property as any individual holds his, free from the touch of a creditor who has acquired no lien: free also from the touch of a stockholder who, though equitably interested in, has no legal right to, the property. Becoming insolvent, the equitable interest of the stockholders in the property, together with their conditional liability to the creditors, places the property in a condition of trust, first, for the creditors, and then for the stockholders. Whatever of trust there is arises from the peculiar and diverse equitable rights of the stockholders as against the corporation in its property and their conditional liability to its creditors.'"

On page 404 Mr. Justice Peckham further states:

"Insolvency is a most important and material fact, not only with individuals but with corporations, and with the latter as with the former the mere fact of its existence may change radically and materially its rights and obligations. Where there is no statute providing what particular act shall be evidence of insolvency or bankruptcy, it may be and it some-

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times is quite difficult to determine the fact of its existence at any particular period of time. Although no trust exists while the corporation is solvent, the fact which creates the trust is the insolvency, and when that fact is established at that instant the trust arises. To prove the instant of creation may be almost impossible, and yet its existence at some time may very easily be proved. What the precise nature and extent of the trust is, even in such case, may be somewhat difficult to accurately define, but it may be admitted in some form and to some extent to exist in a case of insolvency.

"Hence it must be admitted that the law does create a distinction between solvency and insolvency, and that from the moment when the latter condition is established the legality of acts thereafter performed will be decided by very different principles than in a case of solvency."

Stockholders should be held as partners to the amount of their stock when insolvency is established.

This principle was strongly put in **Schalucky vs. Field** (1888), 124 Ill., 617. In this case the charter of the Illinois Bank provided that "when default shall be made in the payment of any debt or liability contracted by said corporation, the stockholders shall be held individually responsible for an amount equal to the amount of stock held by them respectively, etc."

The language used by the Court in placing a construction upon the liability is as follows:

> "The stockholders, with respect to their personal liability under such a provision as Section 9, are, in effect, partners, and are liable, as such, to the creditors of the corporation to an amount equal to the amount of stock held by them respectively. The stockholders in the German Savings Bank assumed a primary liability to the creditors to pay the indebtedness of the bank to the amount stated in Section 9. When a debt was contracted by the bank, the liability of those who were then stockholders, attached, and from that moment, they became bound in the same manner and with like effect as if they had been doing business as partners unincorporated, except that the liability of each stockholder was limited to an amount equal to the amount of stock held by him."

Morawetz on Private Corporations, aptly puts the situation of the stockholder upon insolvency. In Vol. 1, Sec. 166, he says:

> "After a corporation has become insolvent, it is the duty of the company to wind up its business, call in the outstanding capital, and satisfy creditors. The shares have ceased to be the subject matter of legitimate traffic. They are a burden to the owner, and a transfer would be merely a subterfuge to avoid liability."

In the case of the **National Bank vs. Case,** 99 U. S., p. 628 (1878), this Court quotes the case of **McClaren et. al. vs. Franciscus,** 43 Mo., 452 (1869). In this case the Court did not found its views upon any question of knowledge on the part of the defendant. Their language is as follows:

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"The law is well settled, the point is very clear, that no member can exonerate himself from liability or defeat the claims of creditors, by transferring his interest to an insolvent person or a bankrupt. The members of a corporation, therefore, who would be liable, if they continued members, to the creditors of the corporation, may still be treated as members if they have disposed of their interest to an insolvent or with the view of exonerating themselves from their personal responsibility. The authorities all concur in this. (Ang. & Ames on Corp., Sec. 623.)

"The facts in this very case furnish an illustration of the foregoing rule. Some time previous to the issuing of the execution, Franciscus had sold his stock to DeBaun, whom the evidence clearly proves to have been insolvent at the time of the sale. It is true there was no transfer made on the books; so there could be no dispute about fixing the liability of Franciscus. But had the transfer been regularly made, it would have amounted to the same thing, as DeBaun's insolvency would have still left Franciscus responsible."

In **Sawyer vs. Hoag**, 17 Wall., 610 (1873), Mr. Justice Miller clearly defines how the contract between the creditor and the stockholder should be viewed, and gives strong reasons why ignorance should never free a stockholder from his contract. He states:

"After all, this artificial body is but the representative of its stockholders, and exists mainly for their benefit, and is governed and controlled by them through the officers whom they elect. And the

interest and power of legal control of each shareholder is in exact proportion to the amount of his stock. It is, therefore, but just that when the interest of the public, or of strangers dealing with this corporation is to be affected by any transaction between the stockholders who own the corporation and the corporation itself, such transaction should be subject to a rigid scrutiny, and if found to be infected with anything unfair towards such third person, calculated to injure him, or designed intentionally and inequitably to screen the stockholder from loss at the expense of the general creditor, it should be disregarded or annulled so far as it may inequitably affect him."

All the decisions which take the view that the insolvency of the bank does not affect a stockholder so as to prevent a transfer of his stock, utterly fail to recognize that insolvency creates a trust and changes at once the rights of all parties, and that it is but equitable, that in any character of partnership, insolvency should at once prevent any member of the partnership escaping liability to the detriment of creditors. It is true it may at times be difficult to establish exactly the date of insolvency, but that is not a reason for saying that when that insolvency has been established, it is not in any way to affect the rights of a stockholder unless he has knowledge of it.

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Insolvency may interfere with the transfer of shares of stock in a corporation, but is it not just that it should limit the right of sale? As Morawetz says, "The shares have ceased to be the subject matter of legitimate traffic. They are a burden to the owner and a transfer would be merely a subterfuge to avoid liability."

The reasoning of the Court of Appeals from which this writ of error is taken presents the objections that are usually urged but does not justify its decision.

Judge McPherson in giving the opinion of the Court states "there is no restriction in the Banking Act forbidding transfer after the bank has become insolvent." . . . . "As Congress has imposed no restriction on the right to sell." . . . . "Section 5139 provides that such shares shall be transferred on the books of the bank as the by-laws may prescribe," "it is merely a question of public policy whether the right of transfer shall be restricted" (p. 66).

It is respectfully submitted that this is begging the question. It cannot be said that Congress has imposed no restriction on the sale of stock until

it has been determined, how far the right of transfer on the part of the stockholder is limited by the obligation imposed upon him by Section 5151 of the United States Statutes. Under this section he is held individually responsible for the contracts, debts and engagements of the bank to the amount of his stock; until it is decided when this obligation attaches, a stockholder cannot be said to have a free right of transfer, or that his liability is a question of public policy.

The learned Court says in its opinion that no principle of justice or fair dealing forbids a transfer of the stock if the transfer is *bona fide* and in ignorance of the bank's insolvency and the seller is therefore seeking no unfair personal advantage but is merely exercising innocently an apparent statutory right.

It is respectfully submitted that if the stockholder's liability to the creditor has attached by reason of the insolvency of the bank it is no answer for the stockholder to say that he has escaped his personal liability without any knowledge that he was doing so, and that by escaping he was not seeking in any way to be unfair to the creditor. It is immaterial what the stockholder

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intended to do or what he thought. The question is, did the stockholder transfer his stock when he was bound by his contract with the creditor not to do so? And did he thus escape a liability to the creditor which he voluntarily assumed and under which he secured the creditor's money?

The learned Court states that a transfer made by a stockholder in ignorance of the fact that the bank was insolvent is not forbidden by public policy, and gives the five following reasons to refute a contrary view:

> "*First.*—The reason being that harm to the creditors should be prevented, an irresponsible shareholder ought to be permitted to transfer to another irresponsible person; for, in that event, the creditors would suffer no harm, and no reason would exist for restricting the statutory right to sell at will" (p. 67).

Because in some instances a transfer by an insolvent stockholder to another insolvent stockholder would not injure the creditor, as he could have no hope of recovery against either, it seems hard to deduce that this should be a reason for depriving him of his right to recover when the contract of indemnity would be of some value; it is immaterial that the contract may, under certain conditions, be of little protection. If it is in force, it should be executed for the benefit of the creditor as far as the

courts have power. They cannot create assets, but they can enforce rights. The reason given by the learned Judge may be one why the creditor would not apply to the Court for protection, but it is hardly one which would affect the Court in determining whether he was entitled to assistance when he asks that a transfer of stock be set aside which has been made in violation of the contract with him.

The liability of a stockholder is by virtue of a legal contract, which either does or does not exist. Whether the contract will be of no value by reason of the insolvency of the contracting party does not seem material or relevant. It is new doctrine to say that because a man loses his right against one debtor through insolvency it is a reason why all solvent debtors should likewise escape him.

The second reason given by the learned Judge is as follows:

> "*Second.*—The reason, if sufficient, ought logically to be extended so as to strike down transfers to insolvent persons made while the bank was solvent, as well as to be applied to transfers made after it had become insolvent; for the same harm is done to creditors in the one case as in the other, and in both cases a withdrawal of the statutory security ought upon the assumption to be prevented" (pp. 67, 68).

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It is respectfully submitted that this is not the question. It is immaterial what harm has been done or will be done the creditor before his right of recovery attaches against the stockholder. His contract was made to prevent an injury to him upon the happening of a certain event, namely, the insolvency of the bank. Until that has happened no liability has attached to the stockholder. He is at liberty to transfer to whomsoever he may please, whether the transferee be solvent or insolvent. The limitation to his right of transfer only exists when the bank is unable to fulfill its contracts, and until that happens the creditor has no right to object; it is therefore illogical to extend the doctrine asked for in this case to the extent of preventing stockholders from transferring their stock when a corporation is perfectly solvent, and it is directly contrary to the decisions of this Court that hold that insolvency alone fixes the liability. It does not seem convincing to say that because the law gives no remedy when there is no likelihood of injury it intended to give none when the injury is certain.

The third, fourth and fifth reasons given by the learned Judge may be considered together.

> "*Third.*—The rule would, or at least might, involve inquiry into the solvency of three persons—the

seller, the purchaser, and the bank; and the inconvenience of such an inquiry in each of many possible suits is entitled to weight in determining the applicability of the rule" (p. 68).

"*Fourth.*—In every litigated case the question of the bank's solvency, at least, at a particular date before its doors were closed would be in issue; and as this question is one of fact for the determination of a jury, it is readily conceivable that either because the amount of evidence was not the same in every case, or because different juries were disposed to take different views of the same facts, there would be conflicting verdicts concerning the bank's solvency at substantially the same instant of time" (p. 68).

"*Fifth.*—To apply such a rule would, in the language of defendant's counsel, 'introduce into all transactions an element of uncertainty, for every transaction would be subject to review, even though made in good faith, if it subsequently proved that at the date when the transfer was made the bank, if then liquidated, would have proved insolvent, and that the transferee, if called upon to pay at that day all his debts, would have been unable to respond" (p. 68).

To hold that it is contrary to public policy that a stockholder's liability to pay his assessment upon his stock should attach as soon as a bank becomes insolvent, because of the inconvenience in establishing the insolvency of the bank prior to the closing of its doors, is inconsistent with the argument of the defendant's counsel and with the decisions of this Court. If a contracting party is to be

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relieved of his obligation because of the difficulty or inconvenience of proving insolvency, should he not *a fortiori* be relieved because of the difficulty of proving both that and the more difficult thing that he knew of it? Counsel argue that it would be perfectly proper and not contrary to public policy to hold a stockholder liable for the assessment when the bank was insolvent if the stockholder *knew* the bank was insolvent and assigned his stock. This is undoubtedly true and it would be no answer to say that it would be difficult for the receiver or the creditor to show the insolvency of the bank; and the creditor should, therefore, on grounds of public policy, be allowed to escape. If the difficulty of establishing insolvency is to exempt, the rule should be applied to the case of a stockholder with knowledge of the insolvency as well as to one without.

In **Stuart vs. Hayden,** 169 U. S., p. 1, Mr. Justice Harlan says (pages 8 and 9:

> "If the bank *be solvent* at the time of the transfer, that is, able to meet its existing contracts, debts and engagements, the motive with which the transfer is made is, of course, immaterial."

These words clearly show that in every case where an attempt is made to attack the motives of

a stockholder in assigning his stock, and the good faith of the transaction, you must invariably establish the insolvency of the bank at the time the transfer is made or the question of good faith does not arise; the right to prove such insolvency has never been questioned.

The reasoning of the Court of Appeals would effectually bar all suits where the facts admittedly warranted a recovery. In this case the trial Judge stated that the plaintiff could recover if the defendant had knowledge of any facts that put her upon notice that insolvency existed when she sold her stock, but how could he recover if a jury was not competent to determine that there was an insolvency? To recover the plaintiff would be required to show, not only that the defendant had fears of an insolvency, but that insolvency actually existed. The Court charged the jury that when the defendant sold the stock, "if his design or if his purpose is with a distinct knowledge of impending insolvency of the bank, or if he has circumstances from which he infers that this liability is about to become a positive, fixed liability, etc., . . . the sale will not avail him."

As the defendant had not had her stock trans-

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ferred upon the books of the bank, the receiver (under **Casey vs. Galli,** 94 U. S., p. 673, and numerous other decisions) must seek to recover the assessment by an action at law. If then the contention of the lower Court is sound, no recovery can be had against her, no matter what her knowledge may have been, it not being competent to show to a Court and jury that insolvency existed.

In the numerous cases which have been taken to the Supreme Court the defendants had transferred their stock, and consequently bills in equity were filed to have such transfer set aside; in each case the insolvency was either admitted or proved, and in every instance the insolvency was proved to exist before the bank closed its doors, and the happening of this latter event did not fix the time when the liability of the stockholder attached.

Insolvency of purchaser or transferee.

It is contended by counsel for defendant in error that when the decisions refer to the purchaser as being irresponsible, they mean a man who could not pay for his stock when he purchased it. Plaintiff in error does not admit that this contention is sound, but if it is, it would

be difficult to find a stronger case in this respect than the present one.

The purchaser in this case not only did not pay for the stock himself, he embezzled the purchase money from the bank for the purpose. The creditors of the Chestnut Street National Bank by this transaction as it now stands, by reason of the insolvency of the purchaser, have not only lost the power to collect the assessment upon the stock, they have in addition lost its face value in actual cash, that cash being handed to the stockholder, who is now trying to escape liability, out of the cash drawer of the bank by her own agent's fraud. Such facts show the justice of this Court's rule that the transferee of stock must be able to respond to the obligations of the transferrer, otherwise the latter does not escape his liability if the bank was insolvent when the transfer was made.

Decisions of different States.

In its opinion the Court of Appeals states:

> "The plaintiff in error has referred us to cases decided in several States under their respective constitutions and statutes that seem to support his contention concerning the nature and time of maturity of a shareholder's liability. These decisions hold that the liability is fixed, either absolutely or *sub modo*, by the fact of insolvency; but we do not dis-

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> cuss them, because the National Banking Act and the decisions of the Supreme Court of the United States have established a different rule in respect to shares in a national banking association" (p. 66).

It is respectfully submitted that neither the learned Court or counsel for the defendant in error have quoted any decisions of this Court to support the statement of the Court below, nor does an examination of the National Banking Act show that it establishes a different rule, and the learned Court subsequently state in their opinion that the answer to the question of the liability of the stockholder must come from "the principles of justice and fair dealing"; an answer so deduced would hardly be necessary if an Act of Congress settled the question. The decisions of the other States referred to by the lower Court are instructive, as they show that the liability here contended for is not a great hardship upon the stockholder nor against public policy or fair dealing.

The Ohio cases serve to illustrate the equity of the rule contended for. In that State, both the Constitution and the General Corporation Act provide for the individual liability of the stockholders of a corporation for its debts.

The constitutional provision is as follows:

"Dues from corporations shall be secured by such individual liability of the stockholders, and other means, as may be prescribed by law; but in all cases each stockholder shall be liable over and above the stock by him or her owned, any account unpaid therein, to a further sum at least equal in amount to such stock."

Article 13, Section 3:

The Corporation Act provides: "All stockholders of any railroad, turnpike, or plank road, magnetic telegraph or bridge company, or any joint stock company organized under the provisions of this Act, shall be deemed and held liable to an amount equal to their stock subscribed, in addition to said stock, for the purpose of securing the creditors of such company, and the trustees or directors of every society or association incorporated under Section 66 of this Act, shall be deemed and held individually liable, for all debts contracted by them for their respective societies or associations." S. C., 310; *4 Curwen*, 2582.

The first case in which the liability imposed by these laws came up for construction, and in which the same principles are involved as in the present case, was **Brown vs. Hitchcock** (1881), 36 Ohio St., 667: That was an action brought by a creditor of a corporation against the corporation and its stockholders to subject the stockholders to the payment of a judgment previously recovered by the plaintiff against the corporation, which was insolvent. Some of the defendants were stockholders at the time the

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debt was contracted, and some had transferred their stock prior to the suit and insolvency of the company.

There were two principal questions involved in the case:

First.—As to when the liability attached in favor of creditors.

Second.—Whether after the liability attaches a stockholder is discharged by the subsequent assignment or transfer of his stock.

With regard to the first question, the Court held that the individual liability of stockholders attaches in favor of creditors at the time the debt is contracted or the liability incurred by the corporation.

The Court, referring to the constitutional and statutory provisions, say, on page 678:

> "Under these provisions, it seems to us that the security furnished by the stockholder's liability, in addition to that of the corporation, attaches in favor of creditors at the time the debt is contracted or the liabilty incurred by the corporation.
>
> The corporation itself is a mere legal entity, existing only in legal contemplation, and is created for the convenience and benefit of the stockholders. All its dealings are for and on their account. It can contract no debts except under the authority, express or implied, of the stockholders, and through their corporate agents. Our constitution and laws, there-

> fore, make it an essential condition to persons thus availing themselves of the instrumentality of a corporation for the transaction of business that the security of their personal liability shall attach to and attend all corporate liabilities."

As to the second question, the Court were of the opinion that after the liability had once attached in favor of a creditor a stockholder could not discharge it by a subsequent transfer of his stock. The language of the Court on this point is as follows:

> "The next question is, whether, after the liability attaches to a stockholder, it is discharged by the subsequent assignment or transfer of his stock. We think it is not. The liability, it is true, attaches to him in respect to his stock, but after it has attached in favor of creditors it becomes as obligatory upon him personally as an express agreement. His successive assignees or holders, by accepting the stock and all the rights and benefits arising therefrom, impliedly undertake to indemnify or discharge him from the liability which attached to him as a stockholder while he held the stock."

The principle enunciated in the case has been repeatedly affirmed, and the case itself, as an authority, has been constantly referred to not only in Ohio but in other States.

In Ohio it has been regularly followed.

> *Wheeler vs. Faurat* (1881), 37 Ohio St., 26;
> *Mason vs. Alexander* (1886), 44 Ohio St., 318;

Harpold vs. Stobart (1889), 46 Ohio St., 397;
Boice vs. Hodge (1894), 51 Ohio St., 236;
Herrick vs. Wardwell (1898), 58 Ohio St., 294;
Wick. Nat. Bank vs. Union Nat. Bank (1900), (S. C. Ohio), 57 N. E. Rep., 320.

The language in several of the above cases shows how deeply rooted the rule has become in Ohio.

Thus, the Judge delivering the opinion of the Court in the case of **Harpold vs. Stobart** (*supra*), said,

After referring to the constitutional and statutory provision, page 403:

> "In construing these provisions, the holdings in this state are to the effect that the individual liability of stockholders attaches in favor of creditors at the time the debt is contracted, or the liability incurred by the corporation, and that such liability is not discharged by the subsequent assignment or transfer of the stock, but the successive assignees impliedly undertake to indemnify or discharge the assignor from the liability which attached to him while he held the stock. This right against the stockholders is intended for the common and equal benefit of all the creditors. As between the stockholders and the creditors, each stockholder is liable severally to all the creditors; but, as between stockholders, there is a proportional liability by all stockholders and right of contribution which grows out of the organic relation existing between them, and, as between them, each stockholder is bound to pay in proportion to his stock. The liability is not a primary fund or resource for the payment of the debts of the com-

pany, but is collateral to the principal obligation which rests on the corporation, and is to be resorted to only in case of the insolvency of the corporation, or where payment cannot be enforced by ordinary process."

In the case of **Wick. Nat. Bank vs. Union Nat. Bank** (*supra*), although the question involved was different, the Court quoted the rule with approval in the following language:

"Those who were creditors at and prior to the transfer are in law presumed to have trusted to the responsibility of the then stockholders as well as to the property of the corporation, and the obligation of the stockholder to the creditor is in the nature of a contract, and although not in form an express personal contract, yet it is of equally binding force. It springs out of, and is co-existent with, the contract between the corporation and the creditor. *Brown vs. Hitchcock, supra; Corning vs. McCullough*, 1 N. Y., 47; *Hawthorne vs. Calef*, 2 Wall, 10; 17 L. Ed., 776; *Norris vs. Wrenschall*, 34 Md. 492; *Hager vs. Cleveland*, 36 Md., 476. There arises therefore a manifest equity in favor of such creditors."

Again in **Rider vs. Fritchey** (1892), 49 Ohio St., 295, it is said:

"The plaintiff in error was the owner of stock in this insolvent corporation while the action was pending against it. Being a claim for which liability attached to the stockholders, as we have found, it rested upon him to an amount equal to his stock. Before the judgment was rendered he assigned his

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stock to one who, at the beginning of the present suit, and at the time of trial, was insolvent. He could not thus shift the responsibility."

And in the more recent case of **Peter vs. Union Mfg. Co.** (1897), 56 Ohio St., 181, the Court in affirming the rule laid down in **Brown vs. Hitchcock** (*supra*), said on page 204:

"He could not by the sale and transfer defeat the ultimate right of existing creditors to proceed against him on account of these shares, if a resort to that liability became necessary for their protection. His ultimate liability to them was fixed by the circumstance that he owned these shares at the time their claims were contracted."

In Maryland the Code (Art. 26, Sec. 52) provides:

"All the stockholders of any such corporation shall be severally and individually liable to the creditors of the corporation in which they are stockholders, to an amount equal to the amount of stock held by them respectively, for all debts and contracts made by the corporation, until the whole amount of the capital stock fixed and limited by the corporation shall be paid in, one-half thereof in one year, and the other half in two years from and after the incorporation of said company—or such corporation shall be dissolved."

The question as to the effect of a transfer by a stockholder of his stock in a corporation created under this code came up for decision in the case of **Hager vs. Basset** (1872), 36 Md., 476.

In holding that a transfer of stock in a corporation, before the whole capital stock was paid in, would not exonerate him from his personal liability under the code, the Court said, on page 491 :

> "The language of the 52nd Section, it must be admitted, is general in its terms, and does not in words declare whether the individual liability shall attach to such as are stockholders at the time the debt is contracted, or to those holding stock at the time the suit is brought. It is obvious, however, that the protection of the creditor was the paramount object the Legislature had in view, and the Section in question ought to receive such a construction as will best accomplish this object. In conferring the rights and franchises of a corporation upon companies incorporated under Article 26, the Legislature has affixed, as a condition precedent to the exercise thereof, that the stockholders shall be individually liable for the debts of the company until the whole capital stock is fully paid in. The original stockholders, by their acceptance of the charter, and subsequent purchasers in becoming members, must be considered as assenting to the terms and conditions thus imposed, and it is upon the faith of these terms and conditions that the public are invited to give credit to the company. Parties, therefore, dealing with the corporation rely upon this individual responsibility of shareholders, who are personally known to them, as well as upon the responsibility of the company itself. And at a time when these corporations are multiplied to an almost indefinite extent, embracing every department of trade and business in which the most sanguine can hope for success, parties dealing with the corporation may rely with much more

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confidence upon the personal liability of stockholders than upon the property and assets of the company. Accordingly, in *Norris vs. Wrenschall*, 34 Md., 492, this liability of the stockholder and its corresponding obligation to pay the debts of the company was held to be in the nature of a contract. The Court says: 'It is a debt under the statute due from the stockholder to the creditor, springing out of and co-existent with the contract between the corporation and the creditor.'"

The Court then go on to say:

"If so, if it be a debt due from the stockholder to the creditor, co-existent with the contract by the company, it is clear that no act by the stockholder without the consent of the creditor, can exonerate him from the liability thus incurred. The relation of stockholder creates a perfect legal obligation to pay the debts contracted by the company, until the whole capital shall have been paid and it is upon the faith of this perfect legal obligation that parties deal with the company. The liability of a stockholder, being, therefore, in the nature of a contract made between the company, the creditor and himself, we are of opinion that it continues, and is in no manner affected by the mere transfer of his stock. This construction is fully warranted by the language of the statute, and best accomplishes the purpose of the Legislature, namely, the protection and security of creditors. If the construction contended for by the appellant be correct, then the liability imposed by the section in question would necessarily be conditional; that is provided the creditor commenced his suit prior to the transfer of the stock. We find nothing in the language of the statute, nor in the purposes for which it was passed, to warrant such a

construction. Moreover, it denies to creditors the right to look for payment to such stockholders as were alone known to them at the time the debt was contracted, and compels them to seek payment of persons whom they could by no possibility know, and whom if known, they might have refused credit to the corporation.

"The construction we have adopted is also just and equitable as between stockholders themselves. If personal liability is to rest anywhere, it surely ought to be with those who were stockholders at the time the debt was contracted; who had the means of knowing the extent and magnitude of the same, and who could have exercised an influence in the management of the affairs of the company, rather than upon those who became shareholders subsequent to the creation of the debt, and who are in no manner responsible for the same."

The decisions in the State of New York show that the obligation of a stockholder attaches when the debt is contracted with the creditor, therefore the liability cannot be escaped by a subsequent transfer.

Thus in **Moss vs. Oakley** (1842), 2 Hill (N. Y.), 265, where the charter of a mining corporation declared its members jointly and severally liable for the payment of its debts, and who could be sued after execution returned unsatisfied against the company, although the question involved was whether stockholders who had become so after the debt was

contracted could be held liable, the Court said, per Bronson, J., on page 269, with reference to such as were members when the debt was contracted:

> "If the stockholders may be charged as partners, or, what is the same thing, as though there was no act of incorporation, it follows, of course, that those, and those only, are liable who were members of the company at the time the debt was contracted. The construction which charges them, is the one best calculated to render exact justice to both parties. A man who purchases stock, and comes into a corporation after it has been engaged in business, may often be deceived in relation to the number and magnitude of its debts. But while he is a stockholder, he can know something about the extent of obligation contracted by the company, and is not wholly without the means of exerting an influence over those who manage its concerns. And as to those who may deal with the corporation, they bestow their labor or part with their property on the credit of those who are known to be stockholders; and it may be ruinous to the creditor to turn him over to a remedy against persons with whom he did not deal, and who have come into the corporation at a subsequent period. It is true that a member who makes a fraudulent transfer of his shares for the purpose of avoiding his liability may still be treated as a stockholder. (*Marcy vs. Clark*, 17 Mass. R., 330.) But the burden of showing the fraud lies on the creditor; and he will find that no easy task at the present day, when all our sympathies are expended upon the debtor, and those who kindly aid him to live above the law. And besides, shares may be transferred, without fraud, to persons who are much less able to respond to creditors than were those who owned the stock at the time the debt was contracted."

To the same effect are:

Judson vs. Rossie Galena Co. (1842), 9 Paige (N. Y.), 597;

McCullough vs. Moss. (1846), 5 Denio (N. Y.), 567.

In the latter case the language of the Court is as follows:

> "The stockholders are declared to be liable for the payment of all debts. As soon, therefore, as a contract is made the liability attaches, and of necessity to the stockholders at the time, and this cannot be divested except by satisfaction of the demand. It is not strictly a case of guaranty or suretyship, where *laches* or indulgence by the creditor would operate as a discharge. It is a burden imposed on each stockholder as one of the conditions of the charter, that he shall be a principal debtor for all debts or demands contracted by the corporation while he is a member of it. The object of the Legislature was doubtless security to those dealing with the company, and the construction given by the Supreme Court is the only one which can fully and effectually carry out that intention. If their remedy were confined to those owning stock when suit was brought, or when judgment was recovered, or execution issued or returned, great facilities would be afforded for those who had derived the benefit of the labor or property for which the debt was incurred, in the increased value of the stock, or by the receipt of dividends, to avoid personal responsibility by transferring their stock in anticipation of a suit to enforce payment. A creditor would by that means be deprived of the security upon which it is reasonable

> to presume he relied when the credit was given, and be compelled to seek redress from parties who were unknown at the time and whom he might have been unwilling to trust. It is no answer to this view of the case to say that if a fraudulent transfer was made the liability would not be discharged, and that recourse might be had to the prior holder of the stock. Proof to establish such a fact is always difficult, and it is not just or reasonable to impose the necessity of furnishing it on a creditor."

In Tennessee the Legislature has provided in addition to the liability of the corporation that the stockholders of all corporations incorporated under section 21, of the Act of 1875 shall be individually liable to servants and employees of certain corporations for wages.

In **Jackson vs. Meeke** (1888), 87 Tenn., 69, 9 S. W., 225, one of the questions before the Court was whether after such a debt was incurred by the corporation a stockholder could avoid it as a personal claim by a transfer of his stock.

The Court, in holding that such a stockholder was liable notwithstanding the transfer, said:

> "But it is insisted that the defendant, Meek, having parted with his stock in November, 1885, some two years before the suit against him before the justice was commenced, his individual liability for the plaintiff's debt for wages ceased to rest on him, and passed over to his transferee, to whom the

plaintiff must now look. Is this correct? When the wage earners who were in the employ of the Chronicle Company, and contracted with it, contracted upon the faith of this individual liability clause, the offer of the shareholder contained in the clause in question being accepted by the 'servants and employees' of the company, ripens into a binding contract. This binding contract was upon these shareholders who were such at the time the service was rendered.

"This individual liability, when ripened into a binding contract, is beyond the control of the company or its officers; none but those for whose benefit the provision was made can release the contract. To hold differently would practically destroy this provision for the wage earner's benefit. When the shareholder sees the approaching insolvency of the corporation, he has only to make transfer of his stock to a straw man, fold his arms and let the crash come. We hold that the Legislature did not intend to place the life of this security in the hands of the shareholder, but designed to be a security, the burden of which cannot be shifted by the shareholder to another, to the prejudice of the wage earner, without his concurrence."

The same rule has been recognized in Michigan. In that State the statute provides: "The stockholder of every company incorporated under this Act shall be jointly and severally liable, in their individual capacity, for all labor performed for such company, and shall also be liable for the debts of such company for an amount equal to the amount

of any unpaid stock in such company held by them.

In **Voight vs. Dregge** (1893), 97 Mich., 322; 56 W. Rep., 557, an action was brought to recover for labor performed at a time when defendant was a stockholder, and the question was whether the fact that he had ceased to be a stockholder before action was brought would exonerate him from liability.

The Court held the defendant personally liable, notwithstanding he had sold his stock.

It said, after quoting the above statute:

> "By the terms of this Act every stockholder becomes a surety for the corporation upon its labor debts incurred during the period that he is such stockholder. Were he to become such surety by express agreement with the laborer, he would not cease to be so because of the sale of his stock. He might make such arrangement as he chose with the purchaser to assume the liability, but the creditor would not be affected thereby. If it were otherwise, the laborer's indemnity would be insecure. When the obligation is statutory, the stockholder becomes such surety with knowledge of this liability. The laborer contracts with reference to and in reliance upon it, and the Legislature cannot be supposed to have overlooked the danger of loss to the classes sought to be protected, if a mere transfer of stock could be said to relieve the vendor of the stock from his liability. There is some conflict in the books upon this subject, though much of it may

> arise from differences in the statutes. The weight of authority seems to sustain the proposition that the liability is not affected by the sale of the stock."

The California Courts have adopted the Ohio rule.

In approving the Ohio cases the Court, in **Cutting Packing Co. vs. Packer's Exchange** (1890), 25 Pac. Rep., 52, says:

> "This doctrine, it seems to us, is just and reasonable, because, if the transferee should be insolvent, the creditors of the corporation whose claims attached while the transferrer held the shares would not be affected by the transfer; while, on the other hand, if the transferrer, after the transfer, pays his proportion of any indebtedness of the corporation that he was liable for, such payment certainly adds that much to the value of the stock he transferred, and the transferee should reimburse him for the outlay."

In none of the cases quoted is it held that the creditor must show a knowledge on the part of the stockholder that the contingency upon which he contracted to become liable had happened, and the reason is obvious: *It is the happening of the contingency against which the stockholders contracted to protect the creditor that makes the liability, not the knowledge of it.* The decisions quoted show that the State Courts have held stockholders to a much stricter accountability than has been imposed upon national bank stockholders, or is now asked to be

imposed upon them. The State Courts hold that the stockholders contracted with the creditor to see that his debt was paid, and if that debt was left unpaid by the corporation, the stockholder was liable to the extent of his stock, and could not escape that liability, after the debt was contracted, by an assignment to another, even though the corporation during the interval between the time the debt was contracted and the time it was due was perfectly solvent. The United States Court, in *Stewart vs. Hayden, supra*, which is the doctrine which should have ruled the Court below, have been more lenient; they say a stockholder can escape his liability, even after the debt with the creditor has been contracted, if he sells his stock while the corporation is solvent.

The difference then is: The State Courts say the liability of a stockholder to a creditor attaches when the debt is contracted, and being a part of the contract, the stockholder cannot escape his obligation until it has been fulfilled. The United States Courts hold the liability of the stockholder is created when the creditor trusts the corporation, *but it does not attach to him, so as to prevent his escaping by assignment, until the corporation is insolvent.* This

would seem to be as lenient a view as any stockholder should ask.

As was said by the Court in **Billings vs. Robinson** 28 Hun. (N. Y), 140 (1882):

> "This is no more than the general principle of law applicable to the liability of contracting parties, for they are not allowed to discharge themselves merely by subjecting another person to the obligation of performing their contracts."

The plaintiff's third reason why the defendant in error should be held liable to pay the assessment is based on the information which she had and which prompted her to make the sale when the bank was insolvent.

The facts of the present case show that the Act of Congress is of little service and in many cases would practically be repealed if the liability of a stockholder in a national bank is made to turn upon the frame of mind which the stockholder is in when he assigns his stock after the bank has become insolvent.

It was admitted that the defendant sold her stock because the reserve of the Chestnut Street National Bank had fallen off. She knew this meant they were not doing a good business (p. 40).

She had also been told there was no money in small banks. With this knowledge and with a fear of the liability which existed in national bank stock, she sold the stock. (See pp. 38 to 41 of Record.) The significance of a reserve below the legal limit is shown by Section 5191, which provides that if the reserve is not restored within 30 days after notice from the Comptroller, the latter may appoint a receiver.

The learned trial Court, in passing on plaintiff's fourth point, said (pp. 49–50):

> "The law, as the Court understands it and gives it to you, is this, that the stockholder in a national bank, however he may have derived his stock, has in general a right to sell it, and if he is moved to sell it because he is unwilling to hold a stock to which such a liability may attach, that reason for selling it is not one that prevents his being relieved by such a sale from the liability. But if his design, if his purpose is, with a distinct knowledge of impending insolvency of the bank, or if he has circumstances from which he infers that this liability is about to become a positive fixed liability, and as a mere subterfuge, or not to use so strong a word, if for the purpose of escaping a fixed liability, which he perceives or has reason to suppose is about to occur, he relieves himself or seeks to relieve himself by a sale of his stock, the sale will not avail him. Now, having said this, I will re-read that point, because it seems to be quite an important one in the case. The point is: 'It is not necessary that the defendant should have a knowledge of the

fact that the bank was in difficulties when he sold his stock. He could not sell his stock so as to escape liability if he had any reason whatever to make him feel that he was not safe and had better relieve himself from liability.'

"I say I do not affirm that point, because in view of what I have said I do not understand the law to be that merely because he felt himself not safe in holding a stock of that character, would be a reason to prevent his selling it and relieving himself from future responsibility, unless his fear as to safety arose from a knowledge of facts that made him specially apprehensive with regard to the particular stock that he held" (p. 50).

The opinion of the learned Trial Judge shows how impossible it is to define when a stockholder is liable or to reach a satisfactory conclusion when the ordinary rules of construction of a contract are disregarded and an attempt is made to decide by a man's intent when he assigned his obligation, whether he is still liable.

The stockholder in the case at bar admits a general apprehension of the liability imposed upon the bank stock, but the Court below held that this was not enough—that there must be a special apprehension of the stock which the defendant held. The jury is then instructed to determine whether this refined distinction existed in the mind of the stockholder, and are then told they can only find

that the contract is binding if they believe there was some moral turpitude in the mind of the defendant when she assigned her obligation to an irresponsible party. This construction renders the security supposed to be furnished by the double liability of stockholders only available in the grossest cases of intention to defraud, for those cases only can be proved to the satisfaction of a jury.

In the cases which have been submitted to this Court an intent has always been proved, and it has never been necessary for this Court to hold that intention is immaterial if the bank and the transferee are both insolvent, but their words in *Stuart vs. Hayden* and in other cases show that they would so hold when such a case was brought before them. It is a most significant fact that in every case that has been brought to the attention of this Court, the stockholder has never been allowed to escape by reason of any failure to establish intention. If a stockholder had been allowed to escape by reason of a failure to prove intention, the defendant in error might argue that it was necessary to establish such intent, but no decision of this kind has ever been rendered by this Court.

The following cases closely resemble the case at bar in showing the difficulty in defining the evil intent that the lower Courts have thought necessary to establish in order to hold the stockholder to his contract and emphasize the necessity for the rule which has been stated by this Court, that an intent is not necessary, though when proved, it gives an additional ground for holding the stockholder to his obligation:

In **Cox vs. Montague** (1897), 78 Fed., 845, an actual transfer on the books of the bank was made, it was set aside and the vendor held liable. The reports that Montague saw were the published statements just such as defendant was advised about. In this case Sage, J., in delivering the opinion of the Circuit Court of Appeals, said:

> "The rule does not require proof that the transferrer had *actual knowledge of the insolvency of the bank*, and that the transfer was made with a purpose to avoid individual liability. It is enough that if the transferer had '*good ground to apprehend the failure of the bank, and made the transfer to an irresponsible person*, with intent to relieve himself from the individual liability."

In **Baker vs. Reeves** (1898), 85 Fed., Hanford, J., says, on page 837:

"It was a time of general financial depression and it was difficult to *keep on hand the amount of money required as a reserve fund to meet the demands of the depositors.* I am convinced that at the time of making the transfer of stock to his daughter Mr. Reeves hoped and believed that the bank would survive, and that his present would be a benefit, rather than an incumbrance, to his daughter. *But the bank was in a failing condition, and there was then ground to apprehend that it would become insolvent and be compelled to go out of business.* With knowledge of its condition he could not transfer the stock to a person financially irresponsible, and thereby escape the liability of a shareholder for assessments to meet the demands of creditors. *Bowden vs. Johnson*, 107 U. S., 251–264. The defendant Bronson, having received the stock, and being the holder of it at the time of the failure of the bank, is liable for the assessment; and, for the reasons stated, the defendant William H. Reeves is also liable."

In **Foster vs. Lincoln** (1896), 74 Fed., 382, Wheeler, J., says on page 383:

"Creditors of the bank, when becoming such, have a right to rely upon the responsibility of the shareholders as shown by the books at that time; *i. e., the defendant, Benjamin T. Lincoln, appears to have been under liability to the creditors of the bank when this transfer was made.* The statutes seem to intend that this liability should not be impaired by transfer and especially should it not be by transfer merely voluntary. As a bank man he must have known of this liability and he had warning of the straits of the bank by the telegram six days before the transfer. *In these circumstances he must have made*

the transfer in contemplation of this liability, although he did not know what it would amount to and hoped, and perhaps expected, it would not amount to anything."

Remaining Assignments of Error.

It does not seem necessary to present to this Court any argument on the additional assignments of error that were taken to the rulings of the Court below.

Many of the errors assigned have been cured by the verdict, and others are not of sufficient importance to present to this Court at this time. If the main contention which has been presented in this brief is decided in favor of the plaintiff in error, it renders the additional assignments immaterial.

It is therefore respectfully submitted that, under the assignments of error which have been argued in this brief, the judgment of the Court below should be reversed.

Respectfully submitted,

ASA W. WATERS,

CHARLES BIDDLE,

Attorneys for Plaintiffs in Error.